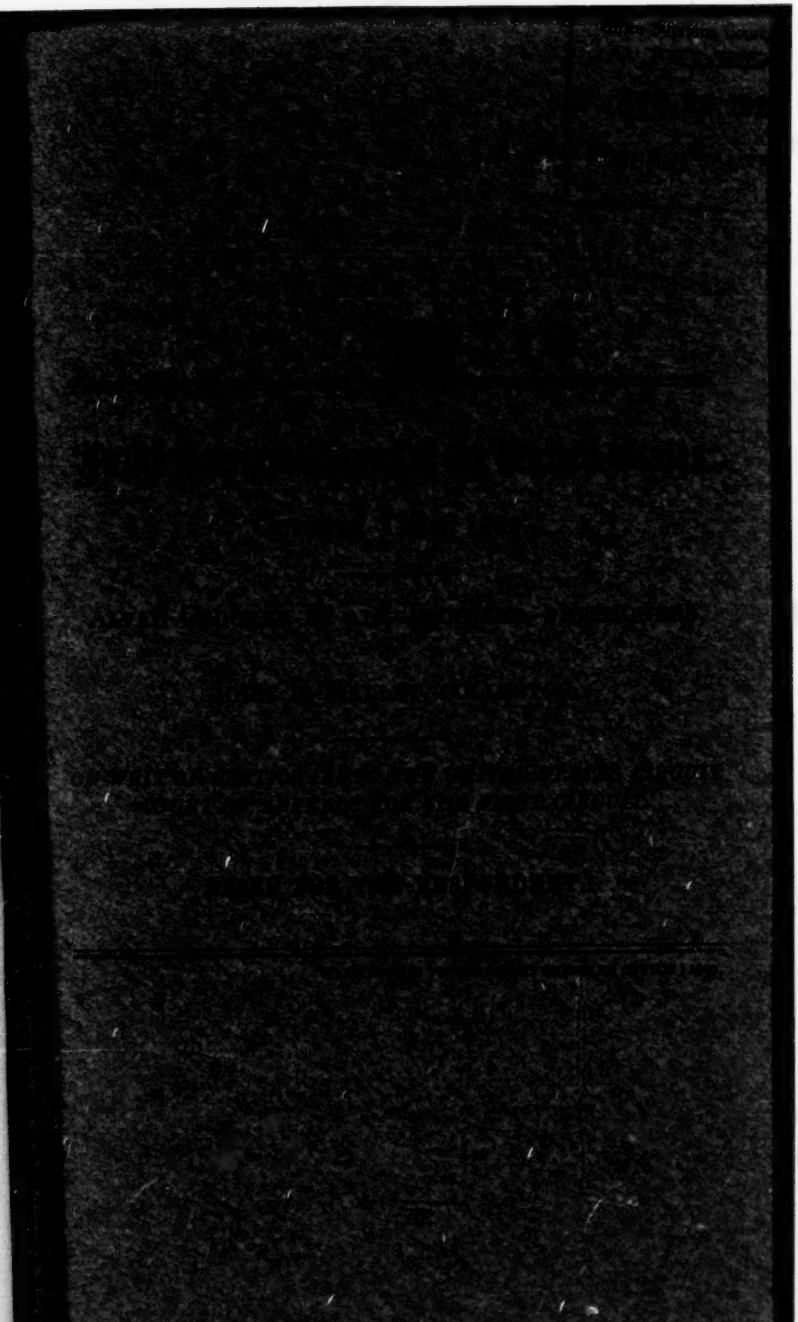

In the Supreme Court of the United States

OCTOBER TERM, 1922.

ALVAH CROCKER ET AL., TRUSTEES, petitioners, v. JOHN F. MALLEY, COLLECTOR, } No. 587.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

BRIEF FOR THE RESPONDENT.

This case comes here by writ of certiorari to the United States Circuit Court of Appeals for the First Circuit which reversed a judgment of the District Court for the District of Massachusetts. The suit was brought to recover $5,212 paid to the collector of internal revenue as the capital stock tax assessed upon the petitioners as trustees of Crocker, Burbank & Co., Assc'n, under the revenue acts of 1916 and 1918. The District Court gave judgment for the plaintiffs, which the Circuit Court of Appeals reversed, 281 Fed. 363.

STATEMENT OF THE CASE.

Crocker, Burbank & Company is a so-called Massachusetts trust and was conceded in the court below to be not a strict trust but an association,

and this concession is made in the note at the foot of page 1 of petitioners' brief in this court.

Conceding it to be a domestic association, the sole claim made is that it has no "capital stock."

Crocker, Burbank & Company is a reorganization of what was formerly The Wachusett Realty Trust, which was before this court in *Crocker* v. *Malley*, 249 U. S. 223. After the decision of that case it changed its form from that of a trust to that of an association by modification of its deed of trust. Its name was changed, and by express terms of the modifying instrument it was provided (p. 8) that "the form of our organization (heretofore a strict trust under the laws of Massachusetts) being hereby changed to that of an association, the name and title of the organization is hereby changed from "The Wachusett Realty Company" to "Crocker, Burbank & Co. Assc'n."

The business in question began many years ago as a partnership under the name of Crocker, Burbank & Company. This partnership was succeeded by a Maine corporation, to which the partnership assets were transferred. About 1912 a Massachusetts corporation was organized, to which seven of the eight mills and most of the real estate of the Maine corporation were transferred. The real estate not transferred to the Massachusetts corporation was leased to it. In consideration of this transfer and lease, the Massachusetts corporation issued all its capital stock, except qualifying shares for officers, to the Maine corporation. The Maine corporation then conveyed all its assets, which consisted chiefly

of stock in the Massachusetts corporation and its reversionary interest in the leased real estate, to trustees of the Massachusetts trust, called The Wachusett Trust, which executed a declaration of trust and issued certificates. This left the Massachusetts corporation as the owning and operating company with all its stock owned by the trust. This was the situation before the court in *Crocker* v. *Malley*, 249 U. S. 233, and it was there held that it was not a joint-stock company or an association and not subject to the income tax in respect to dividends which the trustees received on the stock in the Massachusetts corporation (p. 13).

In 1917 the trust agreement was modified, all the assets of the Massachusetts corporation were transferred to the trustees, and they assumed its debts. From July 1, 1917, to the present time the trustees have carried on the business of paper manufacturing formerly conducted by the Massachusetts corporation. They employ about 1,000 persons and do a gross business of about $10,000,000 a year. The trustees elect a president, vice president, secretary, and treasurer, carry book accounts in the name of the association, and generally conduct the business, and from time to time make distributions of income or profits to the shareholders (p. 13). The trustees individually owned 38,640 shares out of the total of 96,000 shares issued by them. One of the trustees, together with Mr. Rackemann, who is not a trustee, held in trust 18,000 shares. The remaining shares are owned by persons not trustees.

By the declaration of trust it is provided that the trustees may create such reserves as they may consider expedient and hold the same in any form according to their discretion (p. 8).

The fiscal year of the trust shall end on the 1st day of December in each year, and statements of account and condition shall be available at any meeting of the shareholders (p. 8).

The shareholders may hold such meetings as they desire, and meetings shall be called by the secretary or assistant secretary at any time on request of one-third or more in interest of the shares outstanding, and a majority in interest of the outstanding shares shall be necessary to constitute a quorum (p. 9).

At any meeting of the shareholders they may, by a majority vote, remove from office any one or more of the trustees and elect their successors, or fill vacancies so or otherwise occasioned. At such meetings shareholders shall be entitled to one vote for each fractional participation "or share" held by them respectively and "may vote by proxy, as in common corporate form."

The assent of the shareholders to any modification of the trust may be evidenced either by writing signed by a majority in interest of them or by a majority vote at a meeting of the shareholders (p. 9).

The amount of the taxes in question was computed by the collector by taking the fair value of the association's assets over its liabilities and calling the difference capital stock, both under the act of 1916 and the act of 1918 (p. 14).

The form of "certificate of beneficial interest" is shown upon page 19 of the record, by which it appears that the association further conforms to the corporation idea by having a transfer agent, the Old Colony Trust Company. The balance sheet of the association, as of July 1, 1917, appearing on page 20 of the record, shows gross assets of $12,693,345.88. The liabilities, after including a reserve for bad debts, discount, and a general reserve of $500,000 and depreciation of $1,037,029.50, leave as the net value of the property belonging to the "Association Shareholders" $9,877,105.16.

ARGUMENT.

Crocker, Burbank & Company has a capital stock within the meaning of the statute.

The pertinent part of the revenue act of 1916, 39 Stat. 756, is as follows (p. 789):

> SEC. 407. That on and after January first, nineteen hundred and seventeen, special taxes shall be, and hereby are, imposed annually as follows, that is to say:
>
> Every corporation, joint-stock company or association, now or hereafter organized in the United States for profit and having a capital stock represented by shares, and every insurance company now or hereafter organized under the laws of the United States or any State or Territory of the United States, shall pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint-stock company or association, or insurance company equivalent to 50

> cents for each $1,000 of the fair value of its capital stock, and in estimating the value of capital stock the surplus and undivided profits shall be included. * * * The amount of such annual tax shall in all cases be computed on the basis of the fair average value of the capital stock for the preceding year: *Provided*, That for the purpose of this tax an exemption of $99,000 shall be allowed from the capital stock as defined in this paragraph of each corporation, joint-stock company or association, or insurance company: * * *

The section of the revenue act of 1918, 40 Stat. 1057, which is involved is section 1000, reading as follows (p. 1126):

> Sec. 1000. (a) That on and after July 1, 1918, in lieu of the tax imposed by the first subdivision of section 407 of the revenue act of 1916—
>
> (1) Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000, or so much of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of $5,000. In estimating the value of the capital stock the surplus and undivided profits shall be included; * * *

Section 1 of the act provides that, when used in that act—

> The term "corporation" includes associations, joint-stock companies, and insurance companies;

> The term "domestic" when applied to a corporation or partnership means created or organized in the United States; * * *

The act of 1918 was made retroactive (with its increased rate and lesser allowed deduction) for the period covered by the tax in dispute, but it is not claimed that there is any difference in principle between the two acts.

The only distinction between this case and the cases of *Hecht* v. *Malley*, *Howard* v. *Malley*, and *Howard* v. *Casey*, Nos. 532, 533, and 534, argued at this term, is that in those cases the petitioners admit that they have a capital stock but deny that they are associations. In this case the petitioner admits that it is an association but denies that it has a capital stock. As the Circuit Court of Appeals says in its opinion (p. 29):

> Conceding that it is an association with transferable shares, this plaintiff yet seeks exemption on the ground that it has attached no par value to its 96,000 shares. It admits that if it had attached a par value of, say, $100 to each of these shares, making a capital account of $9,600,000, a little less than is shown on its balance sheet of July 1, 1917, where the interest of the shareholders is put down as $9,877,105.16, the concern would have had a capital stock represented by shares, and thus be an association within the meaning of the revenue acts, supra.

Such a distinction is clearly "scholastic and artificial." It can not be believed that Congress

intended to render these organizations taxable or not taxable in accordance with the label which they chose to put upon the capital assets which they owned and employed in their business, or that they could render themselves immune from taxation by failing to label them at all. The tax is to be measured by the fair value of the capital stock and is to include surplus and undivided profits. In other words, the measure of the tax is the value of the corporate assets to which, on distribution, the stockholders would be entitled. That is precisely what is shown upon Crocker, Burbank & Company's balance sheet (p. 20). That Congress did not intend to tax merely the authorized or share capital is shown, first, by the fact that it did not say so, and, second, by the fact that it *did* say that the surplus and undivided profits should be included. If this association had had a definite, fixed sum which it called its capital stock, and which was represented among the shareholders by certificates having a par value, that amount upon the balance sheet would have been carried as a liability, and, when that was added to the other liabilities and the result subtracted from the assets, the difference would be surplus and undivided profits; and the total of capital, surplus, and undivided profits would be the exact sum shown upon the balance sheet as belonging to "association shareholders." In either event, it represents the amount contributed by the shareholders plus the undistributed earnings, and its fair average for the preceding year is the amount which would be the

measure of the tax. The term "capital stock" as representing the sum fixed by a corporate charter does not ordinarily have an "average value." Inclusion of surplus and undivided profits in estimating the value of the capital stock destroys any possible basis for holding the term is used in any such narrow sense. This, too, is shown by the provisions of the two acts relating to foreign corporations. The same section of the act of 1916, section 407, imposing a similar tax upon foreign corporations, requires them to pay a tax equivalent to 50 cents for each $1,000 "of the capital actually invested in the transaction of its business in the United States." Under section 1000 (a) (2) of the act of 1918 the tax upon foreign corporations is based upon "the average amount of capital employed in the transaction of its business in the United States during the preceding year ending June thirtieth." These provisions are perfectly consistent and indicate clearly that it was the intention of Congress in imposing a tax upon domestic corporations to make its measure the entire value of its property, wherever situated; that is, the entire value of its capital stock, and in the case of foreign corporations the proportion of its capital invested or employed in the United States.

The object of these statutes, particularly the act of 1918, was to secure revenue, and revenue in vast amounts. The act of 1918 was a war measure, and the most drastic taxation which this country ever experienced was imposed by that act. It was not intended to exempt large organizations, employing

millions of capital, because they did not follow some particular method of bookkeeping. In the case of *Central Union Trust Company* v. *Edwards*, decided by the Circuit Court of Appeals for the Second Circuit January 8, 1923, affirming 282 Fed. 1008, that court had under consideration a tax assessed against the Central Trust Company of New York under section 407 of the act of 1916. The Central Union Trust Company had a capital stock of $5,000,000 and surplus of $15,000,000 and undivided profits of $2,000,000. For five years prior to the return the corporation had declared dividends of not less than 50 per cent, and during the year preceding the return the average market price of each share sold was $788.75. Good will was not carried as an asset. The Commissioner of Internal Revenue assessed the tax reached by using as a basis for computation what he called the fair value of total capital stock—that is, 50,000 shares at $575.97 per share. This tax was sustained, and this court on April 16, 1923, denied a writ of certiorari to review that decision, which goes far beyond the decision in the case at bar, and includes good will as reflected in the market value of the shares. The opinion of the Circuit Court of Appeals has not yet been reported, but has been printed in Treasury Decisions, February 15, 1923, Internal Revenue No. 3438.

It would be unprofitable to enter into any philosophical discussion of taxes, as taxes are not philosophical products. Nor is it necessary to consider all the meanings that have been given to the words

"capital stock" in the numerous statutes construed in innumerable decisions. The sole question here is the meaning in this particular statute to be derived from its language and intent. The principle was well expressed by District Judge Grubb, who decided the *Central Union Trust Company case* in the District Court, 282 Fed. 1008, 1009:

> The conclusion to be drawn from the authorities would seem to be that the signification to be accorded these words is to be determined in each case by the character of the particular act under construction, and by the language used, and by the context.

The "fair average value of its capital stock" is the measure, and it is to be estimated. The words "in estimating" for the purpose of arriving at a fair average value are wholly inappropriate to the process of copying figures from a certificate of incorporation, nor do they imply that the attempt to estimate shall fail if the certificate shows no figures described as "capital stock." The words "including surplus and undivided profits" put beyond doubt the congressional intent to measure this tax by business and financial realities, not by bookkeeping forms or mere names. The tax was, of course, intended to apply throughout the United States and to affect equally all domestic associations, joint-stock companies, and incorporations, without reference to the great variety of detail in organization and management under the varying conditions in different localities. By whatever name it is called, the shareholders in this enter-

prise have over $9,000,000 invested in a manufacturing business which they are conducting for profit, and which they admit is an association within the meaning of the act. That they do not choose to call it "capital," and avoid designating it by any particular term, does not prevent the courts from giving it its true name, when it is apparent that in substance and in fact it represents the basis which Congress declared to be the measure of the tax to be paid to the United States. It is in every respect the exact equivalent of capital, surplus, and undivided profits, as ordinarily understood.

The judgment of the Circuit Court of Appeals should be affirmed.

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APRIL, 1923.

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